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C O N F I D E N T I A L SECTION 01 OF 02 BUDAPEST 000851

SENSITIVE
SIPDIS

DEPT FOR EUR/CE JAMIE MOORE; PARIS FOR FAA TRICIA STACEY;
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E.O. 12958: DECL: 11/27/2014
TAGS: [PGOV](#) [PREL](#) [EAIR](#) [EINV](#) [EFIN](#) [RU](#) [HU](#)
SUBJECT: TOO IMPORTANT TO FAIL: HUNGARY LIKELY TO REACQUIRE
MALEV AIRLINES

REF: A. BUDAPEST 135
[B](#). BUDAPEST 281
[C](#). BUDAPEST 404

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Classified By: Aaron Feit for reasons 1.4 (b) and (d)

[1](#)1. (C) SUMMARY: Hungarian government, Malev Airlines, and Budapest Airport contacts confirmed that the GOH will likely reacquire a minority stake in recently improved but still debt-laden Malev from Russia's Putin-connected Vneshekonombank (VEB). Embassy contacts characterized VEB as ill-suited to run an airline and willing to sell to avoid the embarrassment of having Malev fail under its ownership. It is unclear when the GOH and VEB will reach a deal, although government sources tell us that the GOH is trying to avoid infusing any more cash into Malev, instead seeking a debt-for-share swap. As Budapest Airport continues its expansion, its fate is directly tied to Malev's survival, with Malev flights accounting for close to 45 percent of total airport traffic. Malev is--at least in the eyes of Hungarian government leaders--too important to fail. END SUMMARY.

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HOW MALEV STALLED
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[1](#)2. (SBU) Hungary privatized its national air carrier, Malev, in 2007. The private holding company is AirBridge Zrt. Today, 51 percent of AirBridge shares are held by a single Hungarian individual, Magdolna Kolto, an arrangement which allows Malev to legally maintain operation as an EU carrier. The remaining 49 percent are held by Russian owned bank Vneshekonombank (VEB) (ref A), which assumed control of AirBridge when the original owner, Russian investor Boris Abramovich, encountered heavy financial trouble. Despite Ms. Kolto's 51 percent holding of Malev shares, in reality VEB finances almost the entirety of AirBridge, Zrt, which makes Malev effectively Russian owned.

[1](#)3. (C) In a recent conversation with Econoff, Malev's former acting CEO and current chief operations officer, Geza Fehervary, detailed some of the difficulties of Malev's performance under Russian ownership. Fehervary stated that Abramovich had "no concept of how to run an airline," and that VEB's acquisition of Malev from Abramovich was not well planned. Russian PM Vladimir Putin has a large stake in VEB (ref B), and Fehervary said that a Malev failure would send a bad signal of Russian inability to manage an important business. Fehervary said VEB is struggling with "internal" problems and has no interest in running an airline. As an

example, he said that the Russian board members--half the company's board membership--typically do not show up to board meetings, adding that not a single board meeting was held the entire summer.

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FLYING, BUT WITH A HEAVY LOAD

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14. (SBU) Switching to the near term, Fehervary said Malev is operating more efficiently with the elimination of long-haul flights and concentration towards European and Middle East routes. About 70 percent of Malev's flights are in western Europe, and Malev's ability to supply "good connections" as part of its membership in the OneWorld alliance is a critical component of its strategy. Malev's eighteen Boeing 737 aircraft are the largest component of its total 27 aircraft fleet. Malev also flies four Q400 planes for short routes -- for example, their newly announced flight to Belgrade -- and plans on retiring their five Fokker 70 planes. Fehervary said Malev would be much healthier with 35-40 aircraft, with 50 as an ideal, to better take advantage of their many foreign landing slots. Currently, there are more potentially profitable routes available to Malev than there are aircraft.

15. (SBU) Fehervary predicted that Malev will have a similar loss in 2009 as it had in 2008, saying that although the company is performing much better under CEO Martin Gauss' leadership, the continuing economic crisis, debt load, and difficulty in securing loans to fund any expansion makes the environment challenging. As a positive, Fehervary said Malev is performing very well in cargo and maintenance services.

16. (C) Asked about recent media reports that the GOH is close to reacquiring a stake in Malev, Fehervary stated that the

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state will "definitely" have some ownership in Malev. In the short term, Fehervary said that state ownership will be good for Malev, but long-term ownership would be adversely impacted by the state's inability to pay competitive salaries, along with the risk of mismanagement and cronyism. Fehervary also said it is difficult to predict how a FIDESZ-led government would manage Malev, once it likely assumes power after next April's general elections. Fehervary said he does not expect concrete improvements until the third quarter of 2010. Looking further ahead, Fehervary stated a state-owned Malev will likely seek private investors again in 2011 or 2012.

17. (C) In a separate conversation with Econoff, Jozsef Super, an economic advisor to PM Bajnai, predicted the government will reach an agreement on Malev. Super also criticized Malev for continuing to run unprofitable routes, citing a daily flight to Bucharest as an example (Comment: This contradicts Fehervary's view that the Bucharest route is profitable, perhaps revealing some of the operational challenges ahead if Malev reverts to state control. End Comment.) Super said the GOH is not planning any cash infusion. Instead, the strategy under consideration is a debt-for-equity strategy, wherein the leveraged portion of the airline would be separated out from the profitable area, possibly as part of a "Malev Group." This would allow a profitable Malev more space to innovate while the debt is managed separately. (Comment: When asked about this plan, Fehervary said that such a proposal is complicated by the possibility of a "new" Malev being legally bound to renegotiate its many foreign landing slots, a process that would set the company back half a year. End Comment.) Recent press reporting on Malev closely aligns to Super's statements.

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BUDAPEST AIRPORT: MARRIED TO MALEV, EXPANSION CONTINUES

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¶8. (C) Close to 45 percent of all flights out of Budapest's Ferihegy airport belong to Malev. The airport was partially privatized in 2005, and is operated privately as "Budapest Airport" (BA) by German construction company Hochtief (ref C). Hochtief also operates airports in Germany, Greece, and elsewhere. In a recent meeting with Econoff, BA's Corporate Affairs Director Mihaly Hardy and Aviation Director Kam Jandu stressed the importance of Malev's survival. Jandu stated, "If Malev disappeared, there is no airline that could come in to replace it, and the airport would quickly become unsustainable." He added that there are 13,000 jobs directly connected to the airport. Given the importance of Malev, Jandu stated that BA leadership is in daily dialogue with Malev management and government ministers on this issue.

¶9. (C) Regarding the airport's ongoing expansion (ref C), Jandu stated that the company's plans remain unchanged and BA is still planning on doubling passenger capacity to 15 million by 2015. Jandu estimated total 2009 traffic will be 8 million passengers (down from a peak of 8.7 million in 2007); however he emphasized that given Hungary's ongoing economic crisis, this is a good result.

¶10. (C) Hardy added that Malev's performance and leadership this year have been excellent, but greatly hindered by their debts. Hardy compared Malev's situation to "having to run a 100 meter sprint while wearing a 20 kg backpack but still finish in less than ten seconds." Despite Malev's troubles, both Jandu and Hardy said they were optimistic about the future of Ferihegy's expansion and goal of making it the predominant central European hub.

¶11. (C) COMMENT: While Malev's leadership has improved this year, it is not a large carrier, is not profitable, and is weighed down by heavy debt. Nonetheless, it is vital to Budapest Airport, important for the tourism sector and Hungarian infrastructure in general. Neither today's MSZP-led government or a probable FIDESZ-led government in 2010 is likely to accept any scenario where Malev ceases operations under their watch. Knowing this, Budapest Airport leadership continues their expansion plans. A GOH stake in Malev is helped by Vneshekonombank's willingness to sell, but with the cash-poor GOH trying to avoid putting up more capital, it is unclear when a deal may be reached. END COMMENT.
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